

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2 COMMISSIONERS

3 MARC SPITZER, Chairman
4 JIM IRVIN
5 WILLIAM A. MUNDELL
6 JEFF HATCH-MILLER
7 MIKE GLEASON

8 In the matter of)

9 ***U.S. BANCORP PIPER JAFFRAY INC.***)

10 ***800 Nicollet Mall***)

11 ***Suite 800***)

12 ***Minneapolis, MN 55402***)

13 ***CRD #665***)

14 Respondent.)

DOCKET NO. S-03537A-03-0000

DECISION NO. 66295

**ORDER TO CEASE AND DESIST, ORDER
FOR ADMINISTRATIVE PENALTIES AND
CONSENT TO SAME
BY: U.S. BANCORP PIPER JAFFRAY INC.**

15 WHEREAS, U.S. Bancorp Piper Jaffray Inc. (hereinafter "USBPJ") is a broker-dealer
16 registered in the state of Arizona; and

17 WHEREAS, coordinated investigations into USBPJ's activities in connection with certain of its
18 equity research and investment banking practices during the period of approximately 1999 through
19 2001 have been conducted by a multi-state task force and a joint task force of the U.S. Securities
20 and Exchange Commission, the New York Stock Exchange, and the National Association of
21 Securities Dealers (collectively, the "regulators"); and

22 WHEREAS, USBPJ has cooperated with regulators conducting the investigations by
23 responding to inquiries, providing documentary evidence and other materials, and providing
24 regulators with access to facts relating to the investigations; and

25 WHEREAS, USBPJ has advised regulators of its agreement to resolve the investigations
26 relating to its equity research and investment banking practices; and

WHEREAS, USBPJ agrees to implement certain changes with respect to its equity research and

investment banking practices, and to make certain payments;

NOW, THEREFORE, the Arizona Corporation Commission (“Commission”) hereby enters this Order:

I.

USBPJ elects to permanently waive any right to a hearing and appeal under Articles 11 and 12 of the Securities Act of Arizona, A.R.S. §44-1801 *et seq.* (“Securities Act”) and Title 14 of the Arizona Administrative Code with respect to this Order To Cease and Desist and Order for Administrative Penalties (“Order”); neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order, and consents to the entry of this Order by the Arizona Corporation Commission (“Commission”).

FINDINGS OF FACT

A. Background and Jurisdiction

1. USBPJ is a broker-dealer with its principal place of business in Minneapolis, Minnesota. The firm engages in a full-service securities business, including retail and institutional sales, investment banking services, trading, and research.
2. USBPJ is currently registered with the Arizona Corporation Commission as a broker-dealer, and has been so registered since 1976.
3. This action concerns the years 1999, 2000, and 2001 (the “relevant period”). During that time, USBPJ engaged in both research and investment banking (“IB”) activities.
4. At various times during the relevant period, USBPJ placed undue emphasis on using its research analysts to maximize opportunities to obtain investment-banking revenues from companies in the technology, telecommunications, and biotechnology industry sectors. Such emphasis on obtaining investment-banking revenue created conflicts of interest for the research analysts that resulted in the issuance of research reports that violated the Securities Act. USBPJ failed adequately to monitor and supervise the conflicts of interest inherent in seeking investment-banking opportunities from companies covered by USBPJ research

analysts. USBPJ's violative conduct, described herein, was caused by a flawed organizational structure, combined with inadequate supervision of the conflicts of interest.

5. USBPJ grouped its research analysts by industry sector and those analysts worked as a team with the firm's investment bankers, who focused on the same industry sector. The majority of research analysts' compensation was paid in the form of bonuses, which for some analysts was directly tied to revenues from investment banking transactions of companies in their industry sector. In other cases, the analyst's contribution to investment banking revenue, and investment banker input into analysts' evaluations played a significant part in determining the analysts' bonuses. In certain cases, investment bankers commented in reviews that research analysts needed to become lead analysts, a reference to using their professional opinions and reports to assist the firm in obtaining the top role in investment banking transactions. As a result of these influences, certain USBPJ research analysts indirectly were motivated to obtain, retain and increase investment-banking revenue.
6. In certain instances, USBPJ also provided draft research reports to potential investment banking clients during sales pitches, and this implicit promise of favorable research was an important aspect of USBPJ's attempts to gain the companies' investment banking business. In other instances, after determining to issue research, USBPJ provided company executives with draft reports, including the proposed rating and target price, and solicited comments on the report from those company executives.
7. USBPJ failed to disclose that it received compensation from the proceeds of underwriting for, among other services, providing research. It also paid proceeds of certain underwritings to other broker dealer firms to issue research on companies whose offerings it underwrote and did not ensure that such payments were disclosed.
8. Finally, USBPJ engaged in improper behavior by threatening to drop research coverage on a company if USBPJ did not receive a certain role in the company's offering of securities.

B. USBPJ's Structure and Procedures Encouraged Research Analysts to Contribute to Investment Banking Revenue, Thus Creating Conflicts of Interest

(1). Overview of USBPJ and the Financial Contribution of its Equity Capital Markets Division

9. USBPJ was founded in 1895.¹ The firm is headquartered in Minneapolis, Minnesota, and has approximately 3,100 employees, including approximately 875 financial advisers, more than 80 investment bankers, and approximately 70 research analysts. USBPJ has operations in 124 offices in 25 states throughout the country.
10. During the relevant period, USBPJ's business included retail brokerage, known as Private Advisory Services; fixed income underwriting, sales and trading (known as Fixed Income Capital Markets); and equities investment banking, syndicate, research, and institutional sales and trading (known as Equity Capital Markets or "ECM"). Thus, equity research and investment banking were in the same business line and, ultimately, reported to the same individual.
11. In 1998, USBPJ generated equity investment banking revenue of approximately \$79,500,000. That increased by 100 percent to approximately \$159,000,000 in 1999. In 2000, revenue from equity investment banking grew to approximately \$269,200,000, a 69 percent increase over 1999. In 2001, USBPJ's revenue from equity investment banking was approximately \$153,000,000. From 1999 through 2001, revenue from equity investment banking represented a significant portion of the firm's revenue, accounting for between 19 – 26 percent of the firm's total revenue.

¹ U.S. Bancorp acquired USBPJ Inc., as a subsidiary in 1998.

(2). USBPJ Aligned Research Analysts With the Firm's Investment Bankers

(a). USBPJ Developed and Implemented Specific Plans To Have Research Analysts Work With Investment Bankers in an Effort to Obtain Investment Banking Business

12. During the relevant period, many companies, particularly those in the technology area, issued stock through public offerings, and there was intense competition among investment banking firms to obtain this business. In order to maximize its chances to participate in these offerings, USBPJ made a concerted effort to include its research analysts in its solicitation of this business. This effort included developing and implementing specific marketing plans, which provided for research analyst involvement in the investment banking process.

(i). Move to the Left Strategy

13. In May 2000, USBPJ's ECM Operating Committee amended its procedures and strategies in a specific effort to gain lead manager status in more offerings. The Lead Manager is the firm typically listed on the left side of the offering prospectus. Thus, USBPJ implemented a plan referred to as the "Move to the Left Strategy." The ECM Operating Committee noted its strong commitment to a "multi-pronged strategy" to obtain lead-manager status on offerings. In instructions to ECM employees, the ECM Operating Committee stated that the firm "must begin to wage a war in earnest for lead-manager status." That plan instituted a "line in the sand" policy: The firm would not accept a syndicate position in any deal unless the firm was placed in the major bracket for the underwriting.

14. The Research Department played an important role in the firm's Move to the Left Strategy. Specifically, to develop a "lead manager mentality," the firm developed a "lead manager Red Zone training program." That program called for the senior bankers, senior research analysts, and Capital Markets personnel to "go through this special training seminar [focused] on pitching for the lead on public equity transactions."

(ii). Lead Manager Protocol

1 15. In August 2000, the head of ECM's syndicate department prepared another specific effort to
2 gain additional lead managed offerings. In setting out his new "Lead Manager Protocol" to
3 all ECM employees, the head of the syndicate department stressed that the "formal protocol of
4 responsibilities ... will allow all of us—Investment Banking, Research, Sales, Trading and
5 Capital Markets—to share responsibility for the success of each and every lead-managed
6 offering."

7 16. The Lead Manager Protocol, issued in August 2000, called for:

- 8 • the lead banker and lead research analyst to make a presentation to the firm's Pre-
9 Commitment Committee before any company would be considered for an underwriting;
- 10 • the research analyst to participate in a "get-to-know-you" session with prospective
11 investment banking clients as part of a "Day at Piper" session;
- 12 • the lead banker and senior analyst to re-present the prospective company client to the
13 Commitment Committee. The lead banker and "senior analyst must demonstrate continued
14 due diligence effort and must provide renewed commitment to the transaction";
- 15 • research and sales to "set up a roadshow schedule to ensure a targeted and efficient
16 roadshow.... [and] focus on ascertaining the right accounts to see and why these are the
17 right accounts;"
- 18 • senior analysts to "provide aggressive pre-meeting preparation and post-meeting follow-up
19 to each 1-on-1 appointment;"
- 20 • senior analysts to be "available during critical parts of roadshow and pricing"; and
21 • the senior analyst to "coordinate with Capital Markets to sort out the aftermarket intentions
22 of each account."

23 17. The Lead Manager Protocol described a primary function of a research analyst in
24 communicating regarding the progress of the transaction once the firm had obtained a lead
25 management role in an IPO when it stated: "Senior analyst will coordinate with Capital
26

1 Markets to communicate a consistent message regarding the progress of the transaction,
2 acting as a supporter of Capital Markets' message and not as an independent filter The
3 goal of the [s]enior analyst is to reinforce reasonable and exceedable expectations."

4 **(b). Research Analysts "Pitched" for Investment Banking Deals and**
5 **Advocated for the Issuer at Roadshows**

- 6 18. USBPJ's procedures allowed for the close alignment of research analysts with investment
7 bankers in the same industry sector. ECM marketed to potential clients its research coverage,
8 market making and institutional sales as part of the firm's efforts to obtain investment
9 banking business. USBPJ used the slogan, "One Team, One Business" in its marketing
10 materials with prospective investment banking clients. Internally, the company had
11 "transaction teams" that included investment bankers and research analysts.
- 12 19. The emphasis on securing investment banking business through pitches and then selling the
13 securities through roadshows gave rise to conflicts of interest for the research analysts. In
14 some instances, the research analyst became a prime contact person for the company with
15 respect to soliciting investment-banking business. For example, on May 10, 1999, a research
16 analyst wrote to an officer of E-Machines, a potential investment-banking client: "This is my
17 final appeal to be a part of the underwriting team. This is your deal and you control the
18 strings. All we are looking for is ten percent of the economics to participate in the
19 underwriting. This itself should be indicative of my sincere interest in your story ... In the
20 final analysis, it is less important to have bulge bracket firm as a hood ornament than it is to
21 have a quality analyst who will provide you with the support and coverage your company
22 needs."

(c). Research Analysts' Participation in Pitch Meetings Was Important in Obtaining Investment Banking Mandates

20. Before USBPJ made its “pitches” to an issuer for investment banking business, the investment banker, teamed with a research analyst for the appropriate sector, would make a presentation to USBPJ’s Pre-Commitment Committee. This presentation included a recommendation and analysis detailing why the firm should pursue an investment banking relationship with the issuer. After USBPJ determined to compete for a company’s investment banking business, particularly in the case of an initial public offering (“IPO”), the research analyst’s role was influential in obtaining that business.
21. One aspect of a research analyst’s function was to play a key role in the process to “pitch” USBPJ to the prospective client. In certain instances, a research analyst’s role at a pitch meeting with an issuer was to assist investment banking personnel in convincing the issuer that USBPJ should be chosen as the lead managing underwriter for the offering. A research analyst’s presence suggested that the Research Department would work hand-in-hand with the investment bankers to provide service and support for the issuer. Research analysts routinely appeared with investment bankers at pitch meetings designed to help sell USBPJ to the potential client and provided information relating to their research in pitchbooks given to prospective client companies.

(d). In Certain Instances, Pitchbooks Provided to Potential Investment Banking Clients Contained Mock Research Reports Impliedly Promising Favorable Research

22. When investment bankers and research analysts presented “pitches” to prospective investment banking clients, USBPJ typically gave the prospective client a pitchbook explaining the proposed services to be provided by the firm. These pitchbooks detailed, in a most favorable manner, why USBPJ should be selected to underwrite the offering. In addition to providing information about how USBPJ would conduct the underwriting, the pitchbooks routinely

1 included a roadmap of the amount and type of research coverage that USBPJ would provide
2 to support the company if it obtained the investment banking business. In certain instances,
3 USBPJ included a “mock” research report for the companies, containing a valuation analysis
4 and “mock” rating such as “buy,” impliedly promising to the issuer that the research analyst
5 would issue a favorable research report if it selected USBPJ for the investment banking
6 business. In some instances, USBPJ’s mock research reports also included a favorable
7 “mock” target price for the issuer’s stock.

8 23. For example, in August 2000, USBPJ made a pitch to be the lead underwriter for an offering
9 by TheraSense, a medical technology issuer. In preparing for the pitch, a research analyst
10 prepared a mock research report about the issuer and presented that mock report at the pitch
11 meeting. The mock research report noted in several places a proposed rating of “Strong Buy.”
12 The mock report contained very positive news about the company, claiming that its initial
13 sales of the product were “nothing short of breathtaking.” In part, as a result of that pitch, the
14 company awarded USBPJ the role of lead managing underwriter, which generated
15 underwriting fees of \$3,785,512 for the firm when the offering went effective in October
16 2001. USBPJ initiated coverage of the issuer with a “Strong Buy” recommendation shortly
17 after the offering went effective.

18 24. Finally, after USBPJ was awarded an investment-banking mandate, another key function for a
19 research analyst was to provide meaningful support to the firm’s institutional investor clients
20 to ensure that an underwriting was successful. Investment bankers, research analysts and
21 company representatives generally traveled to the offices of institutional investor clients, to
22 meet with them and describe the offering and determine their interest in purchasing the stock.
23 At times, research analysts attended and provided significant assistance at these “roadshow”
24 meetings.

(3). USBPJ Tied Research Analysts' Compensation to Investment Banking Revenue

25. During the relevant period, USBPJ compensated research analysts, in part, based on the amount of investment banking revenue generated within their respective industry sector. This practice created a conflict of interest for research analysts, since analysts were compensated, in part, on issuing objective research and on the firm's success in obtaining investment-banking business.
26. Specifically, USBPJ paid certain analysts a percentage of investment banking revenue and institutional commissions generated by companies in their industry sector. The firm entered into written agreements with at least 16 research analysts to pay them a defined percentage of the revenue generated by the companies they covered. This included revenue from net underwriting profits, institutional sales commissions, trading commissions, equity and debt management fees, mergers and acquisition advisory fees, equity and debt private placement fees, research checks, and syndicate trading profits. The defined percentage set forth in these written agreements ranged from a guaranteed 7 to 15 percent of the revenues generated by the companies in their industry sector.
27. Compensation for other research analysts was comprised of base salary plus a bonus. Investment banking revenue was a significant factor in determining the bonus. The bonus was based, in part, on investment banking revenue received from companies in the specific industry sector that each analyst covered, and the level of contribution the research analyst made in the effort to obtain the investment banking business. The bonus usually formed the majority of a research analyst's total compensation. In 1999 and 2000, for example, more than 85 percent of a typical research analysts' compensation came from the bonus, while in 2001 approximately 77 percent of a typical research analyst's compensation was in the form of a bonus. During that time, research analysts' salaries generally ranged from \$60,000 to \$250,000, while the discretionary bonuses ranged from \$75,000 to \$4,000,000.

- 1 28. In determining the amount of discretionary bonuses, supervisors in the research department
2 considered, among other things, a research analyst's contributions to the firm's success in
3 obtaining investment-banking revenues. Performance evaluations of the research analysts
4 demonstrate this consideration. Research analysts received periodic reports detailing the
5 year-to-date revenues generated by their covered companies. At times, senior investment
6 bankers provided these reports to the research analysts, as well as to investment banking
7 employees, and listed the projected investment banking revenue goals for the covered
8 companies. One supervisor noted in a performance evaluation that a certain analyst should
9 work on becoming a "lead managing analyst." That expression was a reference to the lead
10 managing underwriter position that USBPJ sought in offerings because it resulted in the
11 greatest amount of control and revenue. Thus, the supervisor's expression acknowledged the
12 role that an analyst could play at USBPJ in obtaining investment-banking business. For
13 example, one senior analyst received a salary of \$160,000 and a bonus of over \$3.8 million.
14 In another example, an analyst received a salary of \$130,000 and a bonus of over \$3 million.
15 In both of these instances, the bonus determination included consideration of investment
16 banking and trading revenues for companies in the industry sector covered by the analyst.
- 17 29. The fact that research analysts contributed to the firm's efforts to obtain investment-banking
18 revenue is also evident from the personal goals set by certain research analysts. Some
19 analysts, in setting forth their goals, stated specific investment banking revenue goals and
20 listed the ongoing support of investment banking and sales as important to their continued
21 success.

22 **(4). Investment Bankers Evaluated Research Analysts' Performance and Influenced**
23 **Their Bonus Compensation**

- 24 30. In 2000 and 2001, investment bankers who worked on investment banking business with
25 research analysts participated in the annual performance evaluations of those research
26 analysts. Specifically, in certain instances, investment bankers completed and provided to the

Director of Research a “Banker Peer Review” on certain research analysts. Investment bankers evaluated research analysts using specific criteria, including:

- “proactively generates and shares valuable M&A/strategic ideas;”
- “prepares for pitches and contributes to preparation of pitchbook;”
- “effective in pitches; [and] takes the aftermarket commitment seriously.”

31. Thus, investment bankers provided significant input in the performance evaluation of research analysts which, in turn, influenced the bonus compensation of those research analysts. For example, an investment banker noted in his banker peer review that a particular analyst: “needs to be proactive in pursuing fee-generating companies for his coverage list. He is very focused on big cap names that do not pay.”

32. This review process indicated to research analysts that, in part, their role was to assist the investment bankers and the firm’s investment banking clients.

(5). USBPJ Lacked Procedures and Did Not Adequately Monitor Research Analysts’ Sharing of Draft Research Reports With Issuers

33. In certain cases, prior to the dissemination of research reports, USBPJ research analysts provided copies of their draft reports to an issuer’s executives, and solicited comments and suggestions for such reports. Providing draft research reports to an issuer’s executives could potentially compromise a research analysts’ independence in that the investment banking clients may pressure the analyst to make inappropriate changes to the draft report.

34. Certain draft research reports provided to an issuer included not only the factual portions of a draft report, but also the analyst’s valuation, rating and suggested target price. In some cases, company executives were given electronic copies of the research report, and returned to the firm a “red-lined” version of the report with their comments and edits. For example, on September 27, 2001, a USBPJ research analyst sent a representative of Genta, Inc. an e-mail

1 containing a draft report with a rating. This e-mail stated, " Hope you are doing better. Here
2 is a draft of our initiation note. Please review it and send me any comments you may have.
3 Thanks..." On October 2, 2001, Genta responded to the e-mail with extensive comments on
4 the note.

- 5 35. In other instances, USBPJ investment bankers suggested to issuer clients that research reports
6 initiating coverage would be subject to approval by the issuer. For example, on January 11,
7 2001, an investment banker wrote to numerous executives at Metromedia Fiber Network, Inc.
8 ("Metromedia") thanking them for their meeting with a USBPJ senior research analyst. The
9 banker wrote, "[The analyst] has decided to initiate coverage with a Strong Buy, our firm's
10 highest recommendation...his research associate...will be calling you later today to request
11 help in finalizing the report. *Nothing will be published without your prior approval.*"
12 (Emphasis added). On January 26, 2001, USBPJ initiated coverage of Metromedia with a
13 "strong buy" and a \$27 price target.
- 14 36. On November 22, 2000, a USBPJ senior investment banker wrote to executives of Qwest
15 thanking them for an in-person meeting. The banker wrote: "We expect to initiate research
16 coverage within the next few weeks and will submit a draft of such report for your review and
17 approval prior to publication."
- 18 37. Notwithstanding the potential that research analysts could be subjected to pressure by issuers,
19 USBPJ failed to have adequate procedures or controls to monitor such communications.

20 **(6). USBPJ Lacked Procedures And Controls Sufficient To Monitor The Influence of**
21 **Investment Banking on Research Analysts**

- 22 38. In view of the interaction between research analysts and investment banking described above,
23 USBPJ lacked adequate systems or procedures to supervise the influence that investment-
24 banking opportunities had on research personnel. For example, on January 17, 2001, a
25 USBPJ senior research analyst wrote an e-mail to a junior analyst seeking input as to whether
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1 he should maintain a “buy” rating on Natural Microsystems, Inc. (“NMSS”). USBPJ had
2 downgraded NMSS from “strong buy” in December 2000 based on the company’s
3 announcement that it would likely miss its earnings projections for the year. Upon the
4 company’s announcement in January 2001 that it had, in fact, not met its projections for 2000,
5 the senior analyst again evaluated the company’s rating. In response to the senior analyst’s
6 request for input, the junior analyst responded that, in his opinion, the company should stay a
7 “buy” “taking into consideration banking relationship,” but that absent such considerations he
8 would rate the stock a neutral.

9 39. On January 18, 2001, USBPJ issued a research report that maintained the previously lowered
10 “buy” rating.² The report included a lower price target than that published previously,
11 cautionary statements about NMSS’s short-term prospects and a predicted “struggle” for the
12 company’s shares during the first half of 2001. In the same research report, USBPJ lowered
13 its revenue estimates by almost one half and reduced the earnings per share to show a loss in
14 fiscal year 2001. At that time, USBPJ defined a “buy” rating as: “Expect positive price
15 appreciation over next 12 months; Solid long term company fundamentals; attractive long-
16 term valuation, though shares may be extended based on near-term parameters.” USBPJ
17 subsequently lowered its rating to “neutral” on April 12, 2001.

18 40. Moreover, USBPJ rarely issued a sell rating. During most of the review period, USBPJ had a
19 four point rating scale: strong buy, buy, neutral, and sell. More than 80 percent of the
20 research reports issued contained either “buy” or “strong buy” recommendations, with less
21 than 20 percent of the companies, on average, rated as a “neutral.” Throughout the review
22 period, USBPJ gave less than one percent of companies a “sell” recommendation. In certain
23 cases, the firm would discontinue coverage, usually without explanation, rather than drop a
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26 ² USBPJ widely distributed its research through public services such as Thompson Financial’s First Call and on its
website www.gotoanalyst.com.

1 company to a sell rating. In those cases, therefore, USBPJ had only a three point rating
2 system.

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4 **C. USBPJ Issued Research on Two Companies That Lacked a Reasonable Basis Or Was
Imbalanced**

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6 41. As to two companies, Esperion Therapeutics, Inc. and Triton Network Systems, USBPJ
7 issued research reports that lacked a reasonable basis or were imbalanced.

8 **(1). Esperion Therapeutics, Inc.**

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10 42. In August 2000, USBPJ served as co-manager for the IPO of Esperion Therapeutics, Inc.
11 (“Esperion”) and consequently initiated research coverage of Esperion on September 5, 2000
12 with a “buy” rating. On January 9, 2002, a USBPJ senior research analyst stated in an e-mail
13 to a senior investment banker: “ESPR delayed a pipeline product and completely dropped
14 development of a second pipeline product, giving a reason that was nothing short of hokey.
15 So it was bad news all around....Esperion has not met a single milestone that they have laid
16 out since they went public. Everything has slipped. [Esperion’s CEO] is a good scientist, an
17 awful CEO.”

18 43. Notwithstanding these statements, USBPJ’s January 2002 industry report “Investing in
19 Biotechnology” and research report on January 24, 2002, both reiterated the existing buy
20 rating (now termed outperform).

21 **(2). Triton Network Systems**

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23 44. In July 2000, USBPJ served as co-manager for Triton Network Systems (“Triton”)’s IPO. On
24 August 7, 2000, a USBPJ senior research analyst initiated research coverage of Triton with a
25 “buy” rating and a \$45 price target. Soon after the IPO, shares of Triton reached a high of
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1 \$47.75, but the value of the stock quickly declined. USBPJ maintained a “buy” rating while
2 the stock price declined to \$1 13/16 over the next eight months.

- 3 45. On March 30, 2001, the analyst issued a “blast” e-mail to institutional clients with cautionary
4 statements about Triton due to the likely loss of a key customer, Advanced Radio Telecom,
5 which was considering a Chapter 11 bankruptcy filing. Other than the “blast” e-mail, USBPJ
6 did not issue a new research report directly on that information at that time. Notwithstanding
7 this negative news, USBPJ maintained a “buy” rating. Another month passed before USBPJ
8 disclosed in a broadly disseminated research report Triton’s problems with this customer
9 while downgrading Triton to a neutral on May 1, 2001. After two more months, when Triton
10 was trading below \$1, the research analyst told the head of USBPJ’s equity research
11 department, that since the company was in bankruptcy proceedings, “we can drop now if
12 banking says ok.” USBPJ discontinued coverage of Triton with a last published rating of
13 neutral.

14 **D. USBPJ Threatened to Drop Research Coverage of Emisphere Technologies, Inc., if it Did**
15 **Not Award USBPJ the Lead Manager Role in an Offering**

- 16 46. In September 1999, USBPJ attempted to compel Emisphere Technologies, Inc. to select it for
17 investment banking business by informing company executives that it would drop research
18 coverage of the company if it were not selected as the lead manager for an offering of
19 Emisphere’s securities. USBPJ’s threatening conduct undermined competition for investment
20 banking services.

21 **E. USBPJ Failed to Disclose That it Received Payments From Proceeds of Certain**
22 **Underwritings, In Part, To Publish Research Regarding The Issuer**

- 23 47. From 1999 through 2001, USBPJ received payments out of the proceeds of certain
24 underwritings to compensate the firm for services that included publishing research on the
25 issuer. These payments were made in the form of “research guarantees” or “research
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checks.” During this period, USBPJ accepted more than \$1.8 million in exchange for, among other services, issuing research reports. Despite having an obligation to do so, the firm failed to disclose in research reports or elsewhere that it received the payments, in part, as compensation for issuing the reports. For example:

48. In June 1999, USBPJ received a \$400,000 research check in connection with a \$200 million high yield debt offering in April 1999 for Just for Feet. USBPJ was not a manager on the offering and did not disclose this payment in its ongoing research or elsewhere.
49. In July 1999, USBPJ received a \$150,000 check in connection with an offering of common stock by JDS Uniphase Corp. Although USBPJ was not an underwriter in the offering, the firm received the payment, in part, for continued research coverage of the company.
50. In March 2001, USBPJ received a \$120,000 research check in connection with an underwriting that went effective in May 2001 for Comverse Technology Inc. USBPJ failed to disclose in research it published on the company that it had received this compensation, in part, for issuing research regarding the subject company.

F. USBPJ Failed to Ensure Public Disclosure of Payments It Made from the Proceeds of Underwritings to Brokerage Firms To Issue Research Coverage Regarding Its Investment Banking Clients

51. From 1999 through 2001, at the direction of certain issuer clients, USBPJ paid portions of certain underwriting proceeds to other brokerage firms to initiate or continue research coverage on issuers for which Piper served as lead or co-manager. It knew that these payments were, in part, for research. USBPJ did not take steps to ensure that the brokerage firms paid to initiate or continue coverage of its investment banking clients disclosed that they had been paid to issue such research. Further, USBPJ did not disclose or cause to be disclosed the fact of such payments.
52. For example, in 2000, USBPJ paid underwriting proceeds of \$100,000 to another underwriter in conjunction with USBPJ’s lead manager position on Onyx Pharmaceuticals’ (“Onyx”)

1 stock offering. While this underwriter was not invited to participate in Onyx's offering, the
 2 payment was made in response to a letter dated September 22, 2000 from the underwriter
 3 asking for \$300,000 in "underwriting participation" for continued research and market
 4 making. A representative of the underwriter wrote, "From August 31, 1999 until August 15,
 5 2000, we were the only firm in print on Onyx Pharmaceuticals and we remain a Strong Buy
 6 rating." USBPJ did not ensure that this payment was disclosed to the public in its published
 7 research on Onyx.

- 8 53. In April 2000, USBPJ, acting as lead manager for an offering for Buca, Inc. directed the
 9 payment of an aggregate of \$105,000 to three brokerage firms for the issuance of research. In
 10 February 2001, while assisting in another investment banking transaction for Buca, Inc.,
 11 USBPJ distributed \$225,000 to other firms for their research coverage. USBPJ did not ensure
 12 that these payments were disclosed to the public.

13 **G. USBPJ Failed to Adequately Supervise Its Research Analysts and Investment**
 14 **Banking Professionals**

- 15 54. During the relevant period, USBPJ's management failed adequately to monitor the
 16 activities of the firm's research and investment banking professionals to ensure compliance
 17 with state securities laws and regulations. Among other things, this failure to supervise
 18 gave rise to and perpetuated the above-described violative conduct.

19 **II.**

20 **CONCLUSIONS OF LAW**

- 21 1. The Commission has jurisdiction over this matter pursuant to Article XV of the
 22 Arizona Constitution and the Securities Act.

- 23 2. USBPJ violated A.R.S. §44-1961(A)(13) by:

- 24 i. engaging in acts and practices that created and/or maintained inappropriate influence by
 25 investment banking over research analysts and therefore imposed conflicts of interest on
 26 research analysts. USBPJ failed to manage these conflicts in an adequate and

- 1 appropriate manner;
- 2 ii. issuing research that contained opinions for which there was no reasonable basis and/or
- 3 exaggerated or unwarranted claims;
- 4 iii. inappropriately threatened executives of a potential investment-banking client by stating
- 5 that they would drop research coverage of the company if the firm was not selected as
- 6 the lead manager in an investment banking transaction;
- 7 iv. receiving compensation directly or indirectly, from an issuer, underwriter or dealer, in
- 8 part, for issuing research reports, without fully disclosing the receipt or the amount of
- 9 the compensation;
- 10 v. making payments for research to other broker-dealers not involved in an underwriting
- 11 transaction, when the firm knew that these payments were made, at least in part, for
- 12 research coverage, and failed to disclose or cause to be disclosed in offering documents
- 13 or elsewhere the fact of such payments;
- 14 vi. failing to establish and enforce written supervisory procedures reasonably designed to
- 15 ensure that analysts were not unduly influenced by investment banking concerns.
- 16 Despite knowledge of research analysts' complex responsibilities and conflicts of
- 17 interest, Respondent USBPJ failed to implement a system to detect and insulate its
- 18 research analysts from improper influence and pressure by investment banking
- 19 personnel. To the contrary, Respondent USBPJ's business practices motivated research
- 20 analysts to issue research that would attract and retain investment-banking business.
- 21 3. USBPJ's conduct is grounds for administrative penalties under A.R.S. § 44-1961(B)(1).
- 22 4. USBPJ's conduct is grounds for a cease and desist order pursuant to A.R.S. § 44-
- 23 1961(B)(2).
- 24 5. USBPJ's conduct is grounds for an order requiring the Firm to take affirmative action to
- 25 correct the conditions and practices giving rise to this action pursuant to A.R.S. § 44-
- 26 1961(B)(3).

III.**ORDER**

On the basis of the Findings of Fact, Conclusions of Law, and USBPJ's consent to the entry of this Order, for the sole purpose of settling this matter, prior to a hearing and without admitting or denying any of the Findings of Fact or Conclusions of Law, the Commission finds that the following relief is appropriate, in the public interest, and necessary for the protection of investors.

THEREFORE, IT IS HEREBY ORDERED:

1. This Order concludes the investigation by the Commission and any other action that the Commission could commence under applicable Arizona law on behalf of Arizona as it relates to USBPJ, relating to certain research practices at USBPJ described herein.

2. Pursuant to A.R.S. § 44-1961(B)(2) and (3), USBPJ will CEASE AND DESIST from violating A.R.S. §44-1961(A)(13) in connection with the research practices referenced in this Order and will comply with the undertakings of Addendum A, incorporated herein by reference.

3. Pursuant to A.R.S. § 44-1961(B)(1), USBPJ shall pay an administrative penalty in the amount of \$197,660.00.

4. If payment is not made by USBPJ or if USBPJ defaults in any of its obligations set forth in this Order, the Commission may vacate this Order, at its sole discretion, upon 10 days notice to USBPJ and without opportunity for administrative hearing.

5. USBPJ agrees that it shall not seek or accept, directly or indirectly, reimbursement or indemnification, including but not limited to payment made pursuant to any insurance policy, with regard to all penalty amounts that USBPJ shall pay pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such penalty amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC Final Judgment or otherwise used for the benefit of investors. USBPJ further agrees that it shall not claim, assert, or apply for a tax deduction or tax credit with regard to any state, federal or local tax for any penalty amounts that USBPJ shall pay pursuant to this Order or section II of the SEC Final Judgment, regardless of whether such penalty

1 amounts or any part thereof are added to the Distribution Fund Account referred to in the SEC
2 Final Judgment or otherwise used for the benefit of investors. USBPJ understands and
3 acknowledges that these provisions are not intended to imply that the Commission would agree that
4 any other amounts USBPJ shall pay pursuant to the SEC Final Judgment may be reimbursed or
5 indemnified (whether pursuant to an insurance policy or otherwise) under applicable law or may be
6 the basis for any tax deduction or tax credit with regard to any state, federal or local tax.

7 6. This Order is not intended by the Commission to subject any Covered Person to any
8 disqualifications under the laws of any state, the District of Columbia or Puerto Rico (collectively,
9 "State"), including, without limitation, any disqualifications from relying upon the State
10 registration exemptions or State safe harbor provisions. "Covered Person" means USBPJ, or any of
11 its officers, directors, affiliates, current or former employees, or other persons that would otherwise
12 be disqualified as a result of the Orders (as defined below).

13 7. The SEC Final Judgment, the NYSE Stipulation and Consent, the NASD Letter of
14 Acceptance, Waiver and Consent, this Order and the order of any other State in related proceedings
15 against USBPJ (collectively, the "Orders") shall not disqualify any Covered Person from any
16 business that they otherwise are qualified, licensed or permitted to perform under the applicable
17 law of Arizona and any disqualifications from relying upon this state's registration exemptions or
18 safe harbor provisions that arise from the Orders are hereby waived.

19 8. The Orders shall not disqualify any Covered Person from any business that they otherwise
20 are qualified, licensed or permitted to perform under applicable state law.

21 9. For any person or entity not a party to this Order, this Order does not limit or create any
22 private rights or remedies against USBPJ including, without limitation, the use of any e-mails or other
23 documents of USBPJ or of others regarding research practices, or limit or create liability of USBPJ, or
24 limit or create defenses of USBPJ to any claims.

25 10. Nothing herein shall preclude Arizona, its departments, agencies, boards, commissions,
26 authorities, political subdivisions and corporations, other than the Commission and only to the

extent set forth in paragraph 1 above, (collectively, “State Entities”) and the officers, agents or employees of State Entities from asserting any claims, causes of action, or applications for compensatory, nominal and/or punitive damages, administrative, civil, criminal, or injunctive relief against USBPJ in connection with certain research practices at USBPJ.

IT IS FURTHER ORDERED that this Order shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION

Marc Spitzer

CHAIRMAN

COMMISSIONER

William A. Mundell

COMMISSIONER

Jeffrey Hatch-Miller

COMMISSIONER

Lowell Gleason

COMMISSIONER

IN WITNESS WHEREOF, I, BRIAN C. McNEIL, Executive Secretary of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 24th day of September, 2003.

/s/ Brian C. McNeil

BRIAN C. McNEIL

Executive Secretary

Jim Irvin

DISSENT

DISSENT

This document is available in alternative formats by contacting Yvonne McFarlin, Executive Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail ymcfarlin@cc.state.az.us.

(PAH)

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2 Assistant to the Executive Secretary, voice phone number 602-542-3931, E-mail
3 ymcfarlin@cc.state.az.us.

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26 (PAH)

CONSENT TO ENTRY OF ADMINISTRATIVE ORDER BY
U.S. BANCORP PIPER JAFFRAY INC.

USBPJ hereby acknowledges that it has been served with a copy of this Administrative Order, has read the foregoing Order, is aware of its right to a hearing and appeal in this matter, and has waived the same.

USBPJ admits the jurisdiction of the Commission, neither admits nor denies the Findings of Fact and Conclusions of Law contained in this Order; and consents to entry of this Order by the Commission as settlement of the issues contained in this Order.

USBPJ states that no promise of any kind or nature whatsoever was made to it to induce it to enter into this Order and that it has entered into this Order voluntarily.

James Chosy represents that he/she is Managing Director & Secretary of USBPJ and that, as such, has been authorized by USBPJ to enter into this Order for and on behalf of USBPJ.

Dated this 29th day of August, 2003.

U.S. BANCORP PIPER JAFFRAY INC.

By: /s/ James Chosy

Title: General Counsel

SUBSCRIBED AND SWORN TO before me this 29th day of August, 2003.

/s/ Stacey L. Kline
Notary Public

My Commission expires:

1-31-07